

# Shedding light on...

## Third party information notices



### What are they?

HMRC have various means of obtaining information about taxpayers for the purposes of their investigations. One of these is the use of statutory information notices.

The type of statutory information notice most commonly encountered by financial institutions is a third party notice in respect of a taxpayer. Specific rules apply to these following an agreement between HMRC and the British Bankers' Association. These rules provide that for members of the British Bankers' Association, such notices must be issued either with the approval of the taxpayer under a mandate, or with the approval of the tax tribunal following an application by HMRC. Since a mandate is completed by a taxpayer, the scope of information which is disclosable is restricted to that which the financial institution would be required to provide to that taxpayer (being its customer). By contrast, a third party notice can also extend to a financial institution's own internal records, and there is no obligation on HMRC to notify the taxpayer of it.

We are seeing an increase in HMRC's willingness to issue third party notices on financial institutions. We anticipate that their use will further increase as HMRC ramp up their investigations into tax avoidance, particularly in relation to ultra-high net worth individuals and their families and with the introduction of Financial Institution Notices ("FINS") (as to which see below).

We are also seeing an increase in HMRC using their information notice powers under the so-called "**Enablers Legislation**", which is designed to allow HMRC to tackle marketed tax avoidance schemes, but which has potentially wider consequences for financial institutions that have relationships with taxpayers that implement such schemes.

The scope of these third party notices can often be very broad, requiring the disclosure of all documentation and information the financial institution holds on a customer which, depending on the relationship, may go back many years.

Responding to a third party notice can therefore be a significant and potentially costly undertaking. It also involves potential risks for the financial institution because it involves the production of sensitive information and documents, in circumstances where (i) the financial institution will owe duties of confidentiality to the tax payer (its customer); (ii) the financial institution will be required to make determinations as to what is/is not within scope of the notice; (iii) some of the information or documents may relate to other customers and/or be privileged and/or contain sensitive personal data; and (iv) the tax payer will often be unaware that it is under investigation and, if it were to find out, that might prejudice the investigation and possibly lead to penalties against the financial institution (to the extent it were at fault).

## The current process

If HMRC wish to issue a third party notice with the approval of the tax tribunal, they must first issue an "opportunity letter" to the financial institution. This notifies the financial institution of HMRC's intention to issue a notice and sets out the scope of the information and documentation required. It also invites the financial institution to make representations on the terms of the notice, the substance of which HMRC is then obliged to pass on to the tax tribunal for consideration when HMRC seeks approval.

This, together with negotiating directly with HMRC, is the only way a financial institution can seek to narrow scope, since it has no standing to make representations directly to the tax tribunal, or to request a hearing in relation to a third party notice. However, its ability to do so will be hindered by the fact that it will not be entitled to information about the underlying investigation, given it is not the subject of it.

## The Incoming FIN Process

On 21 July 2020, HMRC announced its intention to amend the current information notices regime (Schedule 36 of the Finance Act 2008) to introduce FINs which will require financial institutions to provide information to HMRC when requested about a specific taxpayer, without the need for approval from the tax tribunal.

The FIN rules are still in the consultation period. Assuming the legislation passes through parliament without amendment, we expect the FIN rules to receive Royal Assent under the Finance Bill 2020-21 at some point in 2021.

Under the proposed rules, a FIN could be issued when the following conditions are met:

1. for domestic requests, the information sought is reasonably required for the purpose of checking a known taxpayer's tax position or for the recovery of a tax debt;
2. for international requests, the information sought is relevant to the administration or collection of tax and the overseas authority requesting the information has exhausted all reasonable domestic ways to get the information;
3. the FIN has been approved by an authorised officer of HMRC; and
4. HMRC has or will tell the taxpayer why the information is needed, unless a tax tribunal rules this condition should not apply (in which case HMRC may require the recipient of the FIN to refrain from informing the taxpayer).

Documents which are subject to legal professional privilege cannot be requested via a FIN.

The introduction of FINs removes the oversight of the tax tribunal, which scrutinises the scope and validity of existing third party notices. These new rules will increase the importance of the relationship between HMRC and the financial institution to ensure onerous and overly wide FINs are not issued.

HMRC say that they are introducing FINs now, as the UK is the biggest exporter of financial services in the world, and it therefore receives a relatively large number of information requests from other tax authorities. HMRC also say that it currently takes the UK 12 months on average to obtain information via an information notice, whereas the target under international standards is six months. It is thought that removing the need to obtain approval from the tax tribunal will speed up the process.

## The Enablers Legislation

The Enabler Legislation was introduced by Schedule 16 to the Finance (No.2) Act 2017 and introduces a penalty for any person who enables the use of abusive tax arrangements (which HMRC later defeats). It is targeted at intermediaries and third parties that HMRC considers are involved in the facilitation (or "enabling") of the arrangement and gives HMRC the power to request documentation/information that a third party might have that relates to a taxpayer's involvement in the avoidance scheme.

A person may be an "enabler" of a tax avoidance arrangement if it is either:

1. the designer of the arrangement;
2. the manager of the arrangement;
3. the marketer of the arrangement;
4. an "enabling participant" (i.e. were it not for the involvement of the third party, the scheme could not have been carried out); or
5. a "financial enabler" (i.e. where the third party provides, directly or indirectly, a financial product to a taxpayer that funds the carrying out of the tax avoidance scheme).

In this regard, financial institutions may unwittingly fall into the categories of being an "enabling participant" or a "financial enabler". Note that if the financial institution can show that it had no knowledge of its client/customer's participation in the avoidance scheme, then it is unlikely that HMRC can levy penalties against it.

That being said, if HMRC has reason to believe that the third party is an "enabler", then HMRC may request certain information and documentation from that person which will aid HMRC in coming to a determination as to whether a tax avoidance scheme has been implemented and whether the third party is an "enabler".



## How Eversheds Sutherland can help

We have extensive experience in this area and can offer an end-to-end service including:

1. **Advising on the terms and implications of any third party notice**, including whether there are grounds to seek to narrow its scope, if so, how this is best achieved.
2. **Advising on the implications associated with the introduction of FINs**, including how the use of FINs will alter the existing data extraction process used by financial institutions in the UK.
3. **Advising on the implications of being issued with a notice to produce information under the “Enablers Legislation”**, including advising on whether the financial institution could be considered an “enabler” itself and the steps it could take to mitigate/eliminate any penalties levied by HMRC.
4. **Managing the production of data**, including its collation (whether in hard copy, electronic or audio form and including from multiple sites and systems) and its review (including for *inter alia* privilege and third party client confidentiality).

The review process is typically the most costly part of responding to a third party notice. We use our market leading review platform, **ES Locate**, to keep such costs to a minimum, in particular its advanced data analytics, which enable us to identify more quickly what information or documents are/are not within scope.

Alternatively, for those financial institutions which wish to manage the process in-house, we offer ES Locate and the support of our Litigation Support and Technology team on a standalone basis. This means your internal team can have direct access to a secure, market leading review environment, as well as the technical support it needs to get the most out of the platform and its functionality.

From time to time we find that HMRC’s request for disclosure of information is not brought to the attention of the bank’s internal legal team. This can cause difficulties if information is disclosed that breaches the bank’s own duties of confidentiality. It is therefore important that a proper internal process is in place for when these requests are made. Again we can help you design such a process if you do not have one in place.

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